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Docket Control
Commissioner Lea Márquez Peterson
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 850007

RE: Arizona Public Service Company (APS or the Company)
Application for Approval of Rates, Charges and Schedules
Docket No. E-01345A-19-0236

Commissioner Márquez Peterson,

Thank you for your November 17 letter requesting that interested parties and the Company work together to reduce costs for customers. We share your commitment to providing reliable service at affordable rates and believe this is a critically important topic that warrants an honest and thorough examination, especially as we make the transition to a cleaner energy future for Arizona.

During my first year as CEO, there has been great effort to align the organization—through our strategy, operations and culture—around a purpose, vision and mission that reflect our commitment to customers. I am proud to say that leaders and employees have embraced this vision in our new APS Promise, an internal framework that defines our commitment to our customers, to the communities we serve and to each other. The APS Promise makes clear that as Arizona stewards, we do what is right for the people and prosperity of our state. It reinforces that our mission is to serve customers with clean, reliable and affordable energy.

Even before I became CEO, in public meetings with the Commission, I described the customer-focused culture I envisioned for our Company, driven in large part by empowering employees to speak up when they see better ways to do things for customers and to challenge the status quo. A fundamental part of the APS Promise includes these principles and encourages employees to drive creative solutions that continuously improve our customers' experience.

We actively apply this mindset to all parts of our mission, especially customer affordability. For example, we have integrated Lean principles—a system that focuses on productivity, efficiency and the elimination of waste—across the enterprise to reduce costs and increase service levels at all facets of the value chain, from how we procure generation resources to how we purchase supplies. We also are currently on track to have 100% of our leaders *Lean Six Sigma White Belt* trained by

year-end. This is one important way we are building our capabilities to identify and capture opportunities to be more efficient and cost-effective for the benefit of our customers. Our focus on customer affordability is not a special initiative or one-time event; it reflects who we are as a company and will continue to be a fundamental principle in our decision-making moving forward.

Also, it is my strong belief and my commitment that we reach better solutions when we include a range of perspectives. As CEO, I have made it a priority to hear from a diverse set of stakeholders, listen to their feedback on our ideas and to hear their own. In my experience, we share the same hopes and goals for Arizona's energy future and can find common ground upon which to build. While there may be different opinions on the best ways to achieve shared energy goals, we will create and participate in forums to find solutions. We want to share and contribute the energy expertise we have gained from serving Arizona for more than 130 years.

With that context, I would like to address some of the key points in your letter and share what APS has done and is doing to reduce costs, especially in the areas you identify. This history and information are not intended to preclude ongoing discussion and dialogue to ensure we are constantly exploring new ideas and embracing new perspectives.

1. APS strives to keep rates affordable and is a partner in Arizona's prosperity through the work we do to make our service territory a great place to live, work and grow a business

As you observe in your letter, competitive rates are not only good for our customers, they make good business sense. We work closely with local, state and national partners to attract new employers and to support existing companies. Our success in this area was recently recognized by the industry's leading publication on the topic, *Site Selection Magazine*, which named APS a "2020 Top Utility in Economic Development."

We offer rate designs and programs that help employers stay competitive while meeting their own energy goals. Since 2016, we have implemented the following:

- A rate to attract high load-factor customers, such as data centers, that need affordable, highly reliable electricity;
- An aggregation rate that lowers energy costs for qualifying chain accounts such as grocery stores;
- An economic development rate option to encourage businesses to relocate or expand, along with a rural municipal economic development rate we have proposed in our current rate case; and
- A time-of-use schedule better aligned to the operating schedules of many businesses.

Additionally, the Company's existing AG-X program for large and extra-large commercial customers as well as the proposed AG-Y program for small and medium business customers will help maintain our state's strong economy by providing APS's industrial and commercial customers with access to market pricing, which helps them manage operational costs and remain competitive.

As the current board chair of the Greater Phoenix Economic Council (GPEC), I understand the critical importance of economic development to the state and, accordingly, have supported a professional economic development team at APS that works closely with local, state and national partners to attract new employers to the state.

The effectiveness of these Commission-approved rates and programs, as well as APS's economic development efforts, is best measured by the 90 companies that chose to locate or expand their operations in the APS service territory since 2017, including Microsoft, Ball Corporation, Nikola Motor, Lucid Motors, USAA and Amazon. These companies have strengthened Arizona's economy and expanded customer growth by creating nearly 18,000 new jobs and investing more than \$5.8 billion in capital expenditures.

Economic development in APS service territory remains robust. APS is currently working directly with a number of companies that could bring an additional 2,700 jobs and more than \$1.6 billion in capital expenditures to the state.

We expect more companies to locate to our service territory because of the competitiveness of our rates, our increasingly clean resource portfolio, and our customer-focused efforts to understand their energy needs and goals. When these employers choose APS, their choice benefits the residents of the state and our economy as well.

2. APS is focused on reducing operational costs, taking advantage of changes in the energy and financial markets, reducing peak-related costs and minimizing subsidies

As mentioned above, APS launched its 'Customer Affordability' effort in 2019 to reduce costs by building new capabilities, streamlining processes and deploying new technologies. The program is expected to deliver long-term, sustainable reductions in cost and streamline our processes, which will have a positive impact on customer bills.

We have focused on savings in our supply chain for a number of years and continue to optimize this area of our operations to lower our costs, which in turn lowers customer rates. In addition to focusing on cost savings in collaboration with our suppliers, we work with them to capture year-over-year efficiency gains, ensure fair market total cost of ownership, mitigate supply vulnerabilities through dual-sourcing and focus on the quality of the services and materials delivered. This broad approach helps us balance the needs of our operations with the cost to our customers.

For example, we packaged our extensive needs for system and technology integration in order to identify a long-term partner who can provide these integration services at an optimal total cost for APS and our customers. Through negotiations, this strategy saved APS, and by extension, our customers, \$1.6 million.

In addition to operational savings, we actively manage our balance sheet and our approaches to the capital markets to ensure the lowest possible cost for our customers. We maintain diversified relationships with financial institutions and routinely evaluate all options for raising capital. We maintain a multi-year credit

facility at APS and a commercial paper program, which provides us with an ability to access capital opportunistically, at the times that will produce the lowest possible cost.

It is important to note that APS is best positioned to provide customers with access to the lowest cost of capital when our financial stakeholders view the Company's regulatory environment and cost recovery as predictable and supportive of timely recovery on investment. In particular, the credit rating agencies that rate the debt of APS view constructive regulation as the principal factor in deriving their view of a company's business risk and in determining its credit ratings, all of which has a direct impact on customer affordability.

Put simply, predictable recovery on investment drives credit rating support, which drives the lowest financing cost for customers.

In the energy markets, APS's philosophy is similar: take advantage of the lowest-price resource available, regardless of whether it is company-owned or not. Each day, our marketing and trading teams look months, weeks, days, and hours ahead to determine how to take advantage of market conditions, which is why we refer to our energy traders as 'bargain shoppers' for customers. APS aims to purchase the most affordable resources available each day, and to sell energy into the market when doing so makes financial sense for our customers.

In addition, APS participates in the Energy Imbalance Market (EIM) which further optimizes generation in the region by creating intra-hour opportunities to sell and buy power with participating utilities. Because of the Power Supply Adjustor, proceeds from sales of APS-generated energy are passed directly to the customer.

In a further effort to minimize costs, APS uses two demand-side management programs—*Cool Rewards* and *Peak Solutions*—to incent and encourage customers to reduce their peak demand. APS has also offered voluntary demand rates for customers for nearly 40 years, which lower customer costs by offering low off-peak prices alongside an on-peak price signal that encourages customers to reduce their peak energy use. The Company's time-of-use rates also encourage energy conservation during peak hours.

To maximize customer savings, APS is a leader in new technologies that expand customer choice and savings. The latest example of this is APS's partnership with Google, which offers residential customers a free Nest thermostat when they enroll in the Company's *Cool Rewards* demand response program. In the first 24 hours after the Company's announcement, 2,000 customers enrolled, which will help to reduce peak demand by up to 2.5 megawatts next summer. We have also created an online APS Marketplace that allows customers to comparison shop for energy-efficient appliances to help them reduce their electricity bill and conserve energy.

APS has been on the forefront of national efforts to lower customer costs by reducing subsidies and cost shifts that increase the average customer's monthly electricity bill. The Commission set important statewide policy when it established the Resource Comparison Proxy (RCP). Replacing net metering with the RCP has facilitated a robust solar market in Arizona while lowering subsidies paid by most customers for the energy choices of other customers.

It's also important to note that a number of subsidies currently embedded in APS's rates are the result of public policy decisions that the Commission has historically viewed as being in the public interest, including rate discounts and other resources for limited-income customers and energy efficiency program costs. APS supports these decisions while recognizing they have an impact on rates for all customers.

3. Securitizing all generating assets would impede the state's clean energy goals, interfere with the Company's ability to attract investment, and lead to higher costs of debt and equity, thereby undermining the intended effect of reducing APS rates

APS is actively exploring the securitization of retiring generation assets, which would result in savings for our customers. However, securitization historically has functioned as a utility financing mechanism of last resort—for example, when assets have been damaged or destroyed by a weather event—and only recently has been used to help utilities transition from retiring coal to a cleaner energy future. Securitization has never been applied in this manner to a company's entire generation fleet anywhere in the country, and to do so would have significant, negative consequences for customers and the Company.

Securitization of all generation assets would force APS to rely solely on debt to finance its investments, including new clean energy investments. Without the ability to earn an equity return on their contributions of capital to APS, investors will be unwilling to invest with APS, which would hinder the Company's ability to attract the capital necessary to provide our customers with clean, affordable and reliable electricity. Given the scale of APS's generation assets, the loss of this investment capital within Arizona would negatively impact not only APS, but Arizona's economy as a whole.

In addition, because power generation makes up approximately half of APS's state-regulatory rate base, or plant in-service, the loss of the entire equity investment capital stream would cripple APS's ability to finance its operations (*i.e.*, having to rely solely upon debt, where APS would otherwise have a balanced portfolio of available capital). As such, securitizing all APS generating assets would pose a significant threat to APS's solvency and the Arizona economy and, ultimately, could serve to increase costs to customers rather than reduce them.

Regarding the performance incentives and the rate decreases you mention in your letter, it is important to be aware that the Commission adopted two performance incentives into cost-of-service ratemaking beginning in the mid-1980s, but quickly abandoned both. In addition, the Company's rate decreases in the mid-1990s and early 2000s were primarily driven by extremely robust sales growth—several times greater than today—combined with a large percentage of the Company's cost of service consisting of fixed generation costs, which were also significantly higher than today.

In other words, the Company's rate decreases two decades ago were a result of conditions that simply do not exist today. Surplus generation capacity has disappeared; APS is now working to meet future demand and maintain reliability while replacing fossil generation with cleaner generation sources, such as solar, wind and storage.

This is an important and necessary challenge, which made your letter both timely and encouraging. As I participate in the energy policy landscape in Arizona, I am impressed by how much the utilities, stakeholders and Commission have in common. Each of us is forging a path toward a carbon-free environment, each of us supports both affordability and reliability for customers, and each of us wants customers' needs to be at the forefront of decision-making.

The issues we must navigate along the way are complex, in part because they are not mutually exclusive. In fact, they are often highly interdependent and must be balanced carefully.

This is demonstrated by the Commission's recent Energy Rules decision, whose scope and implications required long-term, holistic planning, and an understanding that the obligations the rules create for regulated utilities and the associated costs of those obligations are inextricably linked. Hopefully, we can participate in more forums where this type of approach and collaboration produce such meaningful and balanced outcomes.

As outlined in this letter, APS shares your commitment to customer affordability and managing costs. I am confident our actions demonstrate this commitment. We look forward to additional conversations about how to keep rates affordable while fulfilling our obligation to provide reliable service with an increasingly clean energy mix. I hope you will consider all available options by which we can further that dialogue on behalf of our mutual stakeholders and customers.

As CEO, I speak on behalf of our entire company in emphasizing how honored we are to serve Arizona, and how highly we value opportunities to work together on a bright energy future for our state.

Sincerely,

/s/ Jeff Guldner

Jeff Guldner
JG/RJR